PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee

November 14, 1989

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, November 14, 1989, at 2:30 p.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Johnson
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Melzer
Ms. Seger
Mr. Syron

Messrs. Boehne, Boykin, Hoskins, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Black, Forrestal and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Balbach, R. Davis, T. Davis, Lindsey, Ms. Munnell, Messrs. Promisel, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account
Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Keleher, Assistant to Governor Johnson, Office of Board Members, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Broaddus, J. Davis, Rolnick, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Richmond, Cleveland, Minneapolis, and Atlanta, respectively

Messrs. Judd, Meyer, and O'Driscoll, Vice Presidents, Federal Reserve Banks of San Francisco, Philadelphia, and Dallas, respectively

Ms. Krieger, Manager, Open Market Operations, Federal Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
November 14, 1989

CHAIRMAN GREENSPAN. Would somebody like to move the minutes of October 3rd?

SPEAKER(?). Moved.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. We need a motion to accept the Report of Examination of the System Open Market Account, which I believe was distributed a few days ago.

VICE CHAIRMAN CORRIGAN. So moved.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Cross, would you start us off?

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Cross? Lee.

MR. HOSKINS. I have a couple of questions. Did we intervene in support of sterling?

MR. CROSS. No.

MR. HOSKINS. We did not. That was [incorrectly] reported?

MR. TRUMAN. The Desk did operate [in sterling], but--

MR. CROSS. Well, I was talking about for our account. We did operate for the Bank of England in our market.

MR. HOSKINS. As an agent?

MR. CROSS. With their funds, as an agent. We do that quite often for any number of central banks.

MR. HOSKINS. Is the Treasury involved?

MR. CROSS. No, this was a Bank of England operation; all we did was to undertake it in New York.

CHAIRMAN GREENSPAN. I remember that the press was assuming that we were acting on our own account at that point.

MR. CROSS. We haven't intervened in sterling for our own account for as long as I've been in the job.

MR. HOSKINS. This question may not be appropriate for you. Did we disburse any of our funds on the Mexican bridge loan? Because it's being [unintelligible]--

MR. TRUMAN. That was before the last meeting, in early--

MR. HOSKINS. It was already done.

MR. CROSS. That was disbursed and reported at the previous meeting.

MR. HOSKINS. Okay.

MR. CROSS. In fact, there has been a modest repayment since then. So that's [not] all fully outstanding.

CHAIRMAN GREENSPAN. Any other questions for Mr. Cross? Tom.

MR. MELZER. Sam, when did we last have short-term interest differentials as narrow as we have now?

MR. CROSS. Well, they are not only narrow; the Desk was telling me this morning that German interest rates throughout the range beyond six months are now higher than ours. And this is the first time, I suppose, in a decade--maybe [more].

SPEAKER(?). Maybe back in the '70s.

MR. CROSS. I don't know how long, but certainly it has been many years.

CHAIRMAN GREENSPAN. Sam, with a tremendous narrowing--and now you're saying a reversal of spreads--that essentially implies a stable or firming dollar. What happens when the spreads are no longer narrowing or are going against us? In other words, does one assume that, adjusted for that process, there's a much stronger dollar underneath the system?

MR. CROSS. Well, I think people can come to different conclusions on this. But certainly the reasons for investing in the dollar or in the mark are affected by a large number of things in addition to these interest rate changes. The events in Germany in the past few days have been raising concerns about the stability of the political situation there. And that can be a deterrent to investment in the mark, certainly under these circumstances, even though it's generally felt that over the longer pull--if there tends to be movement of more workers into West Germany--that this is very positive for the West German economy. It tends to lead to still higher interest rates because it is going to lead to expansion and pressure on resources, which again may tend to--

CHAIRMAN GREENSPAN. The question I'm asking--and maybe it's more appropriate to ask both you and Ted later because this may be premature--is whether, adjusted for interest rate differentials to the extent that one can do that, the dollar has been very substantially stronger. I see a very significant uptrend, and this flat trend is merely offsetting these other positive elements against the negatives of contracting yield spreads.

MR. CROSS. It's interesting to me at least that, with the interest differentials having declined and in this medium to long-term range totally disappeared, the dollar is still as strong as it is.

MR. TRUMAN. Yes. I think that's one of the factors, as you said, underlying its remarkable resilience in some sense, despite the fact that we've had this [move in the differentials]. So, I think it's fair to say that the last couple of days' movement in the German interest rates has been more a German phenomenon, perhaps associated with a market interpretation of what's going to happen to Bundesbank policy three to six months out in light of all this. This is pretty much what's going on with real interest rates in that context--although there is a bit of a difference between nominal and real interest rates in this process. If you think in the short run that there's going to be some inflationary impact from this--and I think most people would--even given the longer-run positive aspects, you could then say that eventually the Bundesbank will lean against this, at least in nominal terms though maybe not in real terms. We may just be seeing that; and that's a slightly different phenomenon than what might just be driving their--

VICE CHAIRMAN CORRIGAN. What you're saying I think has to be true.

MR. TRUMAN. Yes, it has to be true.

CHAIRMAN GREENSPAN. The only question is: What is the order of magnitude? In other words, it really gets to the question of how significant the yield spreads on--

MR. TRUMAN. Well, Sam went through it. They have gone [up] by 350 basis points since April and the dollar is stronger than it was then. So, you've got to say that something has changed in terms of expectations for the future. The qualification that Sam put in there [relates to] how people also think they can get out if they need to.

MR. CROSS. Short-term differentials vis-a-vis the mark have declined 363 basis points since April; and against the yen they have declined 400 basis points.

CHAIRMAN GREENSPAN. I haven't heard from Mr. Mulford recently; without looking at any of the numbers, I knew it had to be something like that.

MR. ANGELL. The Europeans by and large are forecasting that their inflation rates will not peak until sometime in 1990. I was surprised that   believe that theirs will move to   percent before it turns down on a year-over-year basis. So there is some anticipation there that they have quite a stimulus going.

MR. CROSS. As for the real impact, how much attention these investors pay to inflation-adjusted interest rates is a big question. But it's by no means [clear] that if they think the exchange rate is going to be stable they don't pay too much attention to these differences in inflation rates. If you take the inflation rates into account, Germany's inflation is probably almost a couple of percentage points below ours. And in the real sense, the yield on their longer-term bonds is very high relative to ours. It is a good question as to why they are--

MR. JOHNSON. But a year ago, Sam, their producer prices were running minus 5 to 10 percent; now they're running plus 3 or 4 percent.

MR. CROSS. They're now running around 3 percent, but they did have some one-time changes in taxes and all, which affected--

MR. JOHNSON. Did that improve?

MR. TRUMAN. Well, the dollar's depreciation relative to oil prices [is a factor]. Its impact over the last year on our producer prices--and recently it has gone the other way--has been magnified by the fact that the price of oil has gone up more rapidly than dollar prices have gone up. [Unintelligible] came through into the producer prices.

MR. CROSS. It's very possible over time, as investors begin to pay more attention to this, that they will tend to switch more. But my little story was attempting to say that the interesting thing is the extent to which the investment still is moving into dollar assets in light of these circumstances.

MR. HOSKINS. Sam, does the FOMC still review the Foreign Currency Authorization and Foreign Currency Directive in March?

MR. CROSS. Yes.

MR. HOSKINS. Would it make any sense, since we have changed the rotation of Presidents' [terms on the FOMC] to January to do that review then?

MR. CROSS. It depends on the Committee.

MR. TRUMAN. Well, the Committee may want to take it--

CHAIRMAN GREENSPAN. The February meeting.

MR. HOSKINS. We will do it in February?

MR. BERNARD. Yes.

MR. TRUMAN. Presidents [may] argue against it, but it is true that the task force was targeted to finish its work by the end of March. [If you wait] a month we'll have more--

MR. HOSKINS. No, we have [unintelligible].

MR. TRUMAN. There is much work [to be done]; it's partly a result of that, but--

MR. CROSS. We have been aiming at March in trying to prepare this work that we were going to submit to the Committee.

CHAIRMAN GREENSPAN. Any further questions for Mr. Cross? If not, can I first have a motion to ratify the transactions since the October meeting?

VICE CHAIRMAN CORRIGAN. So moved.

CHAIRMAN GREENSPAN. Second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Also, Sam requested a vote for a one-year extension of the swap line agreements. Motion?

MR. MELZER. So move.

CHAIRMAN GREENSPAN. Second?

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Sternlight.

MR. STERNLIGHT. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Any questions on Peter's report? If there are no questions, do you want to discuss the leeway issue?

MR. STERNLIGHT. Fine. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Are there any questions on the leeway issue? If not, can I have first a motion to ratify the Desk's actions since the October meeting?

SPEAKER(?). So move.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. And similarly, on the leeway request.

SPEAKER(?). Move it.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Mr. Prell and Mr. Truman.

MR. PRELL. [Statement--see Appendix.]

MR. TRUMAN. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. JOHNSON. I graciously point out that your forecast was accurate, but under a different interest rate scenario. And since I ask this every time, to the extent that I follow them: What reasons would you give as to why the forecast will stay on course with a much different interest rate path? What would you say are the major factors?

MR. PRELL. Well, for one thing, we actually did have interest rates rising through the first half of this year. The surprise on the interest rate path has been essentially since the spring. With the lags, one wouldn't have expected a very large deviation over the recent period. As we look forward into the first part of 1990, we get the offsetting influence then of the lagged effects of the dollar firmness on net exports. Those are at least two things that come immediately to mind on how one might be able to explain this.

MR. JOHNSON. By rising rates do you mean the funds rate?

MR. PRELL. Right, particularly [the funds rate].

MR. JOHNSON. But long rates didn't rise, really; they bounced around a little but they generally trended down, I think.

MR. PRELL. They never rose very much; that's clear.

MR. JOHNSON. Yes. So, it was the dollar mainly. And what was the other one?

MR. PRELL. As we look into early 1990 I think these are the two offsetting considerations affecting GNP growth in the first part of 1990: we have lower rates than we anticipated but we have a much higher dollar than we anticipated.

MR. TRUMAN. The dollar forecast error offset the interest rate forecast error.

SPEAKER(?). Right.

MR. JOHNSON. That's what I thought.

MR. TRUMAN. That's the first approximation.

MR. JOHNSON. One other point I'd like to raise is about profits. Corporate profits, of course, have been reported as weak. I was wondering: How closely does the profits picture compare this time to, say, 1984--I don't know if you have this at your fingertips--when I remember we had a similar sort of picture developing in that we had a weakening situation occurring in manufacturing, and I think profits were weaker in that same period; a similar type of squeeze occurred. The funds rate had been raised up until mid-1984, or something like that, and then eased off.

MR. PRELL. I don't think there's any comparison. Looking at the chart that we had in our pre-FOMC briefing yesterday, total nonfinancial corporate profits basically shot up in the early recovery phase and didn't really move much one way or the other through 1984. They began to give way toward the end of that year and have eased off since then almost continuously. But there has been a very sharp drop recently. Now, there are some rather peculiar things in the numbers because of the disasters; they eliminated some profits in the third quarter and we presume that BEA also will recognize the losses in insurance companies and so on in the fourth quarter. So, that's giving us some one-time shocks. But I don't think there's any comparison to that earlier period with what we're seeing now.

MR. JOHNSON. So you'd characterize this as a much weaker profit situation?

MR. PRELL. I think we've had a very marked decline and we're getting to historically low levels of profitability relative to the scale of business.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Ted, I was a little surprised by the severity of the decline in net exports in the third quarter. I just didn't sense the things that you [noted]. Does that seem to be a reasonable figure to you or is that one that we might--

MR. TRUMAN. Of course, it was done without the September numbers and our guess is that the September numbers will move it somewhat in the other direction but not a lot. One of the factors is the oil [developments] that I mentioned. There is a big bulge in non-oil imports; and remember, this is the opposite--like a barrel of oil is valued in 1982 dollars. So it has a big impact on the GNP accounts. Cutting through those two factors, I think it is--

MR. PARRY. Factor income was a big--

MR. TRUMAN. Well, on the factor income side I would say we have no information. That was not up [in] our forecast. And we stubbornly think that they probably overdid it--or underdid it, if you want to put it that way. I say that with some trepidation, since they do make up the numbers--

MR. BLACK. Self-glorified numbers.

MR. TRUMAN. Well--

MR. PARRY. There was such a dramatic change in [factor income] and what they based that on. Why did they come up with--?

MR. TRUMAN. We don't have a good story. Periodically, we try to discuss that with them and we have not gotten a very good story out of it.

MR. PARRY. So that may be it.

MR. TRUMAN. It could conceivably have something to do with the loan loss reserves that were taken by banks and that kind of thing. Conceivably, they may have attributed some of that--. I don't know how they treat that.

MR. PARRY. [Unintelligible.]

MR. TRUMAN. Or something like that. Conceivably, that's one of the factors. That has been one of the factors before but they haven't [told us]. They push these things around, so that may be one of the areas where they have done that. They also have tended sometimes to fudge, but one factor in particular for the third quarter that we tried to take account of is the fact that developing countries may stop [servicing their debt], but there weren't any particular factors of that sort in this period.

CHAIRMAN GREENSPAN. Bob, are you [unintelligible]?

MR. PARRY. No.

MR. GUFFEY. Just as a matter of interest, Mr. Chairman, there have been some comments about trying to project what this German situation may mean for their economy and our economy. I have heard a few comments with respect to the demand that will be generated by these 200,000 or 250,000 immigrants [from East Germany] that are hopefully skilled and will go to work and produce. They will be in a position of demanding the [unintelligible] if nothing else.

SPEAKER(?). Housing.

MR. GUFFEY. Beyond housing.

MR. TRUMAN. Yes.

MR. GUFFEY. What does that imply for their economy and our economy or for interest rates in that market?

MR. TRUMAN. As I said, first of all, we had some of this built into our forecast for Germany because there already had been in the early part of the year a marked increase in the flow of migration to West Germany. So, some of this is built in on both sides. But obviously, in the last couple of weeks (a) things have gotten more so and (b) things have gotten fuzzier in terms of the total overall magnitude. But it is clear that there is going to be more demand in the economy in the short run--by that I mean in 1990 and 1991--than we otherwise would have had. And that will tend to put short-run upward pressure on prices and so forth and so on. Germany is an important market and, of course, it has multiplier effects in Europe. But [East] Germany's exports are 4 percent of total German exports. So it's not big; it's not West Germany, in any case. And as I said, presumably that pressure, given the current state of the German economy, will be met to some extent by Bundesbank policy, at least I think, in terms of the dollar [being] somewhat higher than it otherwise would be. Again, there is some question about what happens to real rates assuming that we [unintelligible] for them. The other aspect is that it has not been decided yet what they are going to do on the fiscal side. I understand that there is at least talk in Germany about having a special tax to finance this sort of thing. So, a lot of these expenditures are transfer payments--for transportation, or publicly subsidized construction in the housing area, and so forth. It's a little hard to shape the whole macroeconomic situation until one is more certain about the overall dimensions and the overall thrust of macropolicy. I think that's one of the reasons why the Bundesbank itself is not going to rule [that] out ahead of time--because they don't know to what extent there will be fiscal policy offsets to this situation.

MR. PARRY. Mike, I have a question. We have had relatively strong growth in real disposable income in the past two years. If you had the traditional relationship between changes in real disposable income and consumption, how much greater strength would we have in consumption in 1990 than shown in the Greenbook, particularly in the nondurables and services areas?

MR. PRELL. I guess I'm not clear how you're connecting the past two years with 1990.

MR. PARRY. Well, typically the [equations] show current consumption as a function of current and lagged values of real disposable income. I think the Greenbook goes into some special factors that may be causing consumption not to be responding as rapidly to changes in real disposable income. So I'm asking: If the relationship were traditional, how much more strength would you get?

MR. PRELL. I don't think we're anticipating anything that is really extraordinary in that relationship. We have personal consumption expenditures next year growing roughly in line with disposable income. One might argue, looking at the rise in the wealth-to-income ratio that we have seen over the past year or more now, that you might tend to get a little stronger consumption growth than income. We haven't put a great deal of weight on that argument. But I don't think we have anything extraordinary, given our income path and that background on the wealth effects. Looking at the gyrations and relationships over the past couple of years, one needs to be mindful of the short-run effects of increases or decreases in farm income--which probably don't feed through to consumption expenditures--and various other special features of the income composition. But looking forward, I think we have a pretty steady relationship here between income and consumption.

MR. PARRY. A lot of the weakness in the economy, if you're looking at the dollar source of weakness, is focused in nondurables; that's down to 1.1 percent, which is very small. And perhaps even more remarkable is services, which got down to 2.6 percent. They have been down that far, but that's not typical.

MR. PRELL. We're expecting rates of growth in those items that would look low by the standards of this expansion. If you somehow felt that everything else was right about this forecast--particularly looking into 1991 when, in our forecast, import prices become a significant factor in creating something of a wedge here in depressing growth of disposable income relative to growth of activity --then you get into questions about whether people are viewing these as transitory terms of trade changes or something more permanent. In effect, we've assumed that people will take the permanent view and that they will reduce their consumption expenditures in line with that weaker disposable income growth. If they persisted, then you would have a tension here, which I think is sort of in the vein of your question.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. First of all, Mike, I've been meaning to ask you about these very substantial differences in our seasonals versus BEA's on the 10-day auto numbers. I assume that you use their data because that's what the GNP is made up of. But why are their numbers so different? I don't remember [the difference] being larger than it was in the first 10 days of November.

MR. PRELL. This is a striking gap. Larry [Slifman] can speak with expertise on this subject. We have been around on this a number of times in the past and have argued with them about it; our raw judgment is that they don't really take a very careful view of the 10-day seasonals. We have tried to, but that still leaves last month with a considerable gap between the monthly numbers.

CHAIRMAN GREENSPAN. Your seasonally adjusted data are smoother than theirs. What do they require for conviction?

MR. PRELL. Given the recent numbers, I think we ought to go back and haggle with them about this some more.

CHAIRMAN GREENSPAN. As I say, it's a very big difference.

MR. PRELL. The product you get differs considerably.

CHAIRMAN GREENSPAN. I would sense that what [they] are saying is that the market is falling apart. You're saying it's asleep.

MR. PRELL. Looking at assembly schedules on our seasonal versus [theirs], on our seasonals you don't have this appearance of a significant gap. Basically with [unintelligible] vendors implied significant inventory accumulation going on. So it's an important question. And this recent 10-day figure just amplifies this again. We'll talk to them some more, but we've had many conversations with them and thought maybe--

CHAIRMAN GREENSPAN. While you're doing that, could you also find out why it is, which I gather is the case for Boskin, that BEA's estimate of the Boeing effect is minus .4 versus our minus .6 percent.

MR. PRELL. I might say that in the past one of the things we have wrestled with BEA over is their willingness to adjust for the timing of model changeovers. We have been a bit more flexible and adaptive on this than they have and that has created, in a number of years, some significant differences in pattern. I don't know whether that's a continuing problem this year, where once again things were not necessarily perfectly aligned with the historical norms.

CHAIRMAN GREENSPAN. Any other questions?

MR. ANGELL. Yes. Mike, in Q1 1990 you have producers durable equipment leading business fixed investment up and then it's back down again in the second quarter. What gives rise to that?

MR. PRELL. That is the Boeing gyration. It's depressing PDE in this quarter and increasing it in the next quarter; then you're back onto the trend of growth.

MR. ANGELL. But that's assuming this strike ends when?

MR. PRELL. Indeed, this is all assuming that the strike ends at the end of this month and then that production gradually gears up to full [speed] by the first of the year. So, obviously, there is room for some significant short-run deviation.

MR. PARRY. There are offsets in inventory, right?

MR. PRELL. Offsets? At this point, since it appears that the suppliers are still providing materials and components to dealers, those are piling up. You're not getting the value added of the assembly. But that could change, too. If the strike went on beyond our assumption, we would expect that to become a factor.

MR. SLIFMAN. Governor Angell, let me just say in answer to your question that once we take account of our assumption about Boeing then we would have, in fact, a rather smooth deceleration in PDE growth over the near term.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I have two questions, which I think are probably related to special factors as well. One that you have alluded to already is the rebuilding effect of the national disasters. It seems that that occurs very quickly and then tapers off. I just wonder about that--with no better information on my part than watching what we see being reported--because it seems that it would require more over a longer period of time.

MR. PRELL. We have a higher level gradually diminishing as we go out through 1990. But it is--

MR. SYRON. It comes on pretty quickly.

MR. PRELL. What we've got built in is not as much as the numbers that one hears--$5 billion or $8 billion that we're looking at in terms of damage and so on. You don't know how much of that really will be replaced; you don't know in the short run how much will be squeezed out by that effort, to the extent that factors of production are reasonably totally utilized in an area. The possibility of doing the repair work and still maintaining the other activity that would have occurred becomes a question. So, I think there is some upside potential here from our forecast on the rebuilding.

MR. SYRON. That was one question I had. The other question has to do with the output figures in 1990. I'm just wondering if there were some special factors contributing to the pattern in output per hour compared to the growth rate in GNP?

MR. PRELL. In productivity?

MR. SYRON. Yes, because you have productivity increasing as GNP is decreasing.

MR. PRELL. Basically, we have the stronger effect as the economy is decelerating. And that's what one normally sees. As labor is adjusted to lower levels of production, you get some bottoming out in the growth and some tendency toward slight acceleration--you move closer to the longer-run trend of productivity expansion.

MR. SYRON. And your longer-run trend is?

MR. PRELL. Something over 1-1/4 percent, maybe.

CHAIRMAN GREENSPAN. Any other questions for the two gentlemen? If not, it's time for us to do our round robin or tour de table. Who would like to start? Mr. Boykin.

MR. BOYKIN. Mr. Chairman, in the Eleventh District there is not very much new to report. I think it's fair to say that the expansion--what little we have had--has slowed. Private nonfarm and farm [income] was basically unchanged between July and September. The

Texas index of leading indicators has fallen for four consecutive months. The declines have been moderate, suggesting continued weak growth rather than a recession. The declines have been led by durable goods manufacturing; nondurable goods manufacturing is holding up a little better. Services have been strong, with growth in business services especially strong. The construction sector does appear to have bottomed out finally. I guess the best words we are hearing are around the Houston and Gulf Coast area, although those words are not quite as good as we were hearing several months ago.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Conditions in the District seem quite consistent with the national trend of moderation, but the moderation is perhaps a bit more apparent in the District because of our very significant commitment to manufacturing and also the importance of the auto companies and export-related activity. And because of that, I think manufacturing may be showing something more of a downturn in our area than is true in the rest of the country. Just to add a word or two to the automotive comments that we've already heard: clearly, sales are down from the higher levels that were recorded this summer. My contacts in Detroit suggest that November and December levels will continue to be under--and I think quite considerably under--the average for the year as a whole. Even though the fourth-quarter production schedules for the domestics are down, nonetheless they anticipate that they are going to go through the end of the year with pretty high inventories at the dealer level. As a consequence, at least one manufacturer has a preliminary forecast of these variables and what strikes me is the size of the decline in production for the first quarter: down 18 percent compared to last year. Other automotive-related businesses obviously are showing signs of weakness. Heavy trucks are down significantly and diesel engine orders for one manufacturer are down 40 percent in September. Given all of this, the unemployment levels in the District are showing signs of increase. In Illinois, for example, unemployment went from 6.2 percent in September to 6.8 percent in October; in Michigan it went from 8.1 to 8.2 percent. If you look at the District as a whole, unemployment numbers are clearly over the national average.

But offsetting that trend there is, I think, some good news in the District. First, the steel business--and it surprises me--has been quite good. The industry has been working off some pretty high inventory positions in a variety of products. They seem to be about through that. So there is an expectation that for some products production is going to pick up. For 1989 shipments are forecast at about 83 million tons; for 1990 the number is lower--from 80 to 81 million tons--but still hardly a [unintelligible]. Farm equipment has been particularly good, given that the production of crops has been completed. Farm income, of course, is good and expected to remain good. Large tractor sales in the third quarter were 15 percent over last year; combine sales were 86 percent over last year's. Clearly, that's a part of the industry that is doing much better. Production is higher but they are going to be very careful not to build up too high an inventory position. Construction activity in the District, particularly on the commercial side, remains surprisingly strong. For [unintelligible], for example, we have about 13 million square feet available for lease and another 9 million under construction. So, we're heading toward a vacancy rate that's going to be in the 15 percent area, which for us is pretty high. Despite that, new building seems to be coming on.

On the inflation side, by and large the current developments are consistent with some moderation built in over a long period of time. Marketplace conditions for farm products seem to be very tight, with not as much latitude there as people would like. In fact, some prices are coming down. In the steel business, for example, the steel plate--[load] bearing or structural--prices really are coming down. And in agriculture, despite this significant improvement in business, they expect price increases next year of about 3 percent--not as much as they would like and certainly very low levels. On the wage front, wage rates are going up but I don't sense any particular big breakout on the up side. And in the manufacturing sector, at least among those that I talk to, people have overcome the [wage] increases with productivity improvements so that costs are remaining in line. So, things are working out about as we expected. I think the fourth-quarter numbers, as more of them begin to emerge, are going to evidence considerably more weakness than we saw in the third quarter.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the economy in the West continues to expand at a healthy pace despite the destructions associated with the Boeing strike and the earthquake. Employment in the Twelfth District grew 3.3 percent over the past year, which is considerably stronger than the 2.7 percent we experienced nationally. Discussions with our directors and other business people in the area indicate that business activity remains robust. But I think there's a generally shared expectation that [it will be] slowing. The Boeing strike shows no sign of a settlement and is beginning to affect the Puget Sound economy which, of course, was the strongest economy in our District. We estimate that personal income has been falling by about $25 to $30 million each week of the strike. Even assuming some generous multipliers, I think that probably translates into less of an effect than is included in the Greenbook, but I'm really not sure about that. If the strike were to continue to the third or fourth month, it is anticipated that the direct income losses would be on the order of about $60 million; but of course there would be secondary effects that would multiply that rather significantly. The negative effects from the quake are likely to outweigh the positive effects during the current quarter. I don't know how much rebuilding refers to the quake and how much actually applies to [hurricane] Hugo, but we feel that is offset by businesses that have slowed significantly due to actual business closures, the loss of tourists, and the interruption of normal traffic patterns. The number of unemployment claims, for example, has skyrocketed in hard-hit areas such as San Francisco where they are up 60 percent. If you get out to the Santa Cruz area, in one of the smaller towns there, Mutsenville, they are up 200 percent. At the present time, recovery efforts are limited to utility repairs, structural inspections, and demolitions--although I know demolitions add to GNP! With a few notable exceptions--the exception being the Bay Bridge, which will be opening Friday--in general there's not much going on in terms of repair and rebuilding for the simple reason that the earth is still shifting and people are unwilling to do anything until that shifting stops. And that typically [lasts for] a 3- to 6-month period.

At the national level, we expect growth to be stronger than that in the Greenbook. We feel that consumption spending should benefit from the lagged effect of the strong growth of disposable income in the past two years. Moreover, strong investment in business equipment is expected to result from backlogs of orders for aircraft; also, the continued reduction in the relative price of information processing equipment should be a positive development and a source of strength for business spending for equipment. In our view, if the economy expands as fast as I think it could, which is around 2 percent, then unemployment will rise only modestly and I think upward pressures on the underlying inflation rate are likely to persist through the end of next year. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Conditions in the Sixth District haven't changed very much over the last couple of meeting periods, Mr. Chairman. We're chugging along at somewhat below the national average. Unlike the San Francisco District, though, we are getting some kick or boost from rebuilding resulting from the Hugo hurricane even though the worst effects were in Bob Black's District. The demand for building supplies and construction materials is coming not only from the Southeast but from the Caribbean as well, and that's giving a good push to transportation as well as to port activity. Beyond that, we're getting pretty good export experience with chemicals and grains as well. But the weaknesses in the Southeast and in the Sixth District economy are kind of overwhelming those positive things and we're seeing a rising unemployment rate--we are at about 6.2 percent in the District as a whole. Some of that is skewed, of course, by Louisiana; but we are seeing unemployment creeping up generally in other states. We have weakness in textiles because of a drop in domestic demand. That is something they have been afraid of for a while; they have been sustained to some extent by foreign demand. But the domestic demand now is beginning to fall off and we're getting corresponding weaknesses in apparel, carpets--carpeting, obviously, is related to the housing shortage--paper, and autos, of course. In construction, even though we have a lot of overbuilding in residential and in office buildings, the financing is available and the construction continues to go on. That's particularly true in Atlanta where we're getting a movement from a lot of class B buildings to class A. The buildings keep going up and I just think we're going to have a pretty bad vacancy problem down the road. Also, we're seeing a buildup in retail inventories and the contacts that I've been talking to don't forecast a very good Christmas season. Prices and labor conditions seem to be okay. We're not getting a lot of price pressures--consistent with the weakness in the economy, I suppose--and labor shortages are not significant.

With respect to the national economy, we think that the economy will be somewhat stronger in the near term than the Greenbook forecast. That's basically because of our forecast for net exports, which we think will be a little higher. I'm not sure whether I have mentioned this before--I think perhaps I have--but I continue to be impressed by the number of people who initiate conversations with me about the softness in the economy. From the auto people and construction people you can expect that, but pretty much across the board I'm getting telephone calls and people stop me on the street and they talk to me at parties about how terrible things are. I think some of this is exaggerated but I'm really paying attention to this. I don't remember that happening before. I think back particularly to 1986 or 1984 when we had some weak quarters and I didn't get this kind of outpouring of emotion about it. I don't know what that tells me in real terms but it's something that clearly gives me some concern. In our forecast we also see unemployment being a little flatter than the Greenbook, but basically we're in accord with the Greenbook. The risk, in my view, is clearly on the down side at this point.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. [Conditions are] somewhat better than I have reported earlier. Although things generally haven't changed much, this is the first time in three FOMC meetings that we've had an increase in nonagricultural employment in the most recent three-month period. We still have some weakness in manufacturing employment--somewhat less than I've talked about the prior two times--but the weak areas are food processing, electrical equipment, and transportation equipment. The electrical sector we've talked about; I think that's largely appliances. The auto area has been mentioned. We've had some shutdowns: a week at the medium and heavy truck plant in Louisville and about a month at one of the two Ford plants there. Chrysler has in [unintelligible] and they have announced that that plant will be closed indefinitely after the first of the year--or actually, one of the shifts will be laid off after the first of the year. It involves somewhere between 1600 and 1900 workers. Interestingly enough, at their other plant, which manufactures minivans, they would like to add a third shift. They made a proposal to the unions for three 10-hour a week shifts and the unions turned it down. So, they could be putting some of those idle workers back to work if they can't get it done. One other comment, which I think confirms what Mike said in the Greenbook in terms of other consumer expenditures ex-autos: We recently had a luncheon with chief financial officers, and two individuals--one with a very large national retailer and another with a smaller retailer--confirmed that they view this environment as ideal for their business. Things are going well and they are quite comfortable with how things are going; that was a bit surprising to me. That's really all I have.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. In an overall sense, I think we ought to be generally pleased. We're trying to steer the economy through a narrow channel and we're doing that. However, I must say that when you are in that narrow channel it looks even narrower than it did before you got there. What I'm sensing is that the risks are more on the side that the economy is going to grow too slowly rather than faster. And I think the Greenbook numbers are too bullish; I think we will see slower growth over the next six months. I'm not running into the same emotion that Bob [Forrestal] is running into. But the sentiment clearly runs between one of concern to bearishness. Real estate people are very bearish; construction--in the residential area--is down and we're going to run into some bankruptcies there. We are headed toward some over capacity in terms of nonresidential construction and I think it's going to take us several years to work through that. Manufacturing is softer in the Third District than it is in the nation as a whole. The retailers feel reasonably good about Christmas, but I don't think their expectations are all that high. So

I [wouldn't describe] the retail area as much more than flat. I make these comments in the overall context that this is what we set out to achieve in terms of steering the economy. But nonetheless, I have more concern that we're going to overdo it on the soft side rather than underdo it. And that will have some effect on my policy prescription in the next part of this meeting.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Well, I'd say the First District economy is mixed to slow. Previously, the declines have been confined to the high-tech area, the real estate area, and generally in construction. But now they are broadening out to the economy as a whole. We actually had total employment over the last three months fall by 1 percent, paced by a 4-1/2 percent decline in manufacturing employment, with nonmanufacturing employment staying pretty flat. Previously, financial services had grown at some pace but that has leveled out now, and many banks particularly are taking steps to reduce costs because of their [unintelligible] problems. We've seen very slight increases in the trade sector. Housing permits are down 30 percent over a year ago and 60 percent from their peak level. And we are beginning to see some decline in house prices, by I'd say 10 to 15 percent, which is different. There's a substantially increased number of auctions as some developers do go bankrupt. Needless to say, loan demand is not terribly strong in this situation. Among the manufacturers that we surveyed that are active nationally, there is actually an amazing degree of almost unanimity in that they are reporting slow growth--not strong growth, but still things are not falling off the edge of the cliff. They're seeing increases in growth of about 6 to 7 percent, and that's because of a wide range of products from telecommunications equipment, milling equipment, and maybe personal care products, with some people saying they have [unintelligible] and greater strength overseas. An exception to this, of course, is suppliers in the auto industry and the computer companies. Computer companies in New England, because of particular product mix issues, just have not benefited from what's happening elsewhere. Actually, that's a lot of the source of the weakness in manufacturing employment. Despite this, inventories generally have not been a problem, although in a few particular cases they have built up. Retailers are not anticipating a good Christmas, which is to be expected in these circumstances; and as you also would expect, they have kept their inventories quite lean in this situation. Prices generally have been very well behaved. There has been some mention of an increase in prices of specialized metals such as tungsten. Labor markets have softened in line with the increase in unemployment that we've seen. And now for the first time--though we've seen this across many skilled classes before--no obviously exorbitant rates are being offered to starting labor at fast food chains.

As far as the national economy goes, we don't have any real disagreement with the Greenbook, which we believe does not show a bad profile for the intermediate term given what we want to accomplish. I think Ed is right: we're steering down a relatively narrow channel here; I'm not quite so sure that I agree that we're listing to one side or the other. The more important question that we're going to discuss is what we want to accomplish over the longer run. I think there's fairly broad agreement within this group that we do want to get to a greater degree of price stability over time. I know at the next meeting we will talk at some length about what the cost of that would be. I would note that the Greenbook assumes that policy remains essentially the same through the middle of next year and then tightens somewhat after that. Even in that circumstance we really don't see any improvement in inflation, as measured by the CPI ex-energy through 1991.

On the labor front, we have seen pretty well behaved settlements. I thought I might just mention the Nynex settlement because I happened to talk last night at some length to one of the mediators in that case. There are two unions involved--the IBEW and the New England Communications Workers of America in New York. This was but it's the same settlement in both places. Sadly, the settlement is not as favorable to management as is suggested in the press releases but it still is not disastrous. Basically, it probably comes down to about a 12 percent settlement over 3 years depending upon what one thinks is going to happen to medical costs. That was the big issue in this strike--virtually all medical costs continuing to be borne by the employer--and that's what people stayed out on. Ultimately, Nynex gave in on that. In terms of wages themselves, the contract provides for 3 percent the first year, 1-1/2 percent in the second year, and 1-1/2 percent in the third year but with a COLA in the second and third year that is equivalent to the CPI minus 2 percent--60 percent of the CPI over 2 percent is a better way of putting it. It is interesting that the inflation assumption that was used or agreed on by both the union and the company was a CPI of 4.7 percent the second year and 4.8 percent the [third year]. The medical cost--and I think this may be on the low side--is estimated at about 2 percent of the cost with regard to the agreement proposal over the life of the contract.

In terms of the relevance of all of this, I believe that we do have to think about this price stability business. One thing that struck me in the Greenbook was that we have two sets of leading indicators and both of them--I think for some time now--have been trending down and showing the probability of a recession. I don't know whether that's [unintelligible], whether we're seeing a symmetrical risk in either direction. So, I'm not really terribly worried about that. I do think we've staked a good deal of credibility and have a lot of credibility right now. That was brought home, and I'll finish on this, by a conversation we had with the chief planner at --and this is kind of an ironic result. He said he was expecting a recession next year because he thought the Fed really wanted to get inflation down and the basic underlying rate of inflation was around 5 percent and that was too high and thus we were going to tighten. Now, this was in a call that was made by one of our economists. But a lot of people are paying attention to what we say and I am concerned that we maintain the credibility that we do have. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, comparing the District economy to the national economy, it looks to me like the District economy continues to do a bit better than the national economy. Agriculture has had a pretty good year; residential construction has picked up a little recently; and mining and forest products and paper industries are all doing well--there's expansion underway in those, certainly in the mining and the paper areas. Tourism had a good year thus far and we're expecting a good winter season; employment gains have been small but the unemployment rates remain low pretty much throughout the District. At the retail level, at least among the major retailers, they have had a good year and they're anticipating a good holiday season and are quite optimistic. Where there has been softness recently is where we've seen it nationally, it seems to me, and that's in manufacturing. One of the questions I've been asking myself is: What are the implications of what we've been seeing in manufacturing nationwide? How much weight ought to be given to what's happening in the manufacturing sector? I think what we're seeing is at least a bit reminiscent of what happened in 1985 and 1986. In going back and looking at that period, manufacturing employment nationwide declined over those two years by about 600,000 workers. For a period of time, at least, new orders for nondefense capital equipment were flat and purchasing managers' surveys showed some weakness. While all that was going on the economy really turned in a pretty respectable performance. Having said that, though, it was also a period when interest rates were coming down and money growth was accelerating. But it seems to me that it tends to emphasize a couple of things of which we're always aware. One is the uncertainty in looking at the outlook. And the second is the caution required, because coming out of the 1985-86 period the real growth continued--if anything probably more strongly than many had expected--and there was some clear uptick in inflation and inflationary pressures at the same time. So my reading of recent economic history suggests that the economy probably can weather some heavy seas at least in manufacturing. It may require a response but it seems to me that we want to be cautious about the degree of that response.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, the Greenbook projections haven't changed very much since last time and neither have ours. We continue to believe that if there is risk, the risk is probably that the economy will be a little weaker than the staff have been projecting. That feeling has been heightened by recent anecdotal information that we've been picking up. I got a particularly interesting piece this morning. A president of one of the small investment firms in Richmond sent me a collection of articles published by a guru he's been following for some 30 years and he said that the problem with the economy was that the Reserve Bank Presidents had recently started attending the Open Market Committee meetings and they were bullying you into accepting tighter monetary policy, which he thought was correct! But more important than that, our directors at their last meeting were decidedly less optimistic about the economy than they had been. They reported weakness in commercial construction and automobile sales a good deal weaker, with several dealerships in trouble. They said manufacturing activity appeared to be softening and loan demand was flat at some of the large commercial banks. But they went ahead to stress that despite all this, they didn't think [the economy] was really falling out of bed. And labor was still very tight. But in view of this indication that we've gotten from various sources, the Fifth District is probably slowing to some extent. Since this area has been one of the stronger parts of the national economy, we think that the national economy, if it isn't right on target with the Greenbook's projection, will perhaps be somewhat weaker than that. At the same time, we're a bit more optimistic--the Richmond Fed staff has been assuming no change in monetary policy--on the inflation side. Given the amount of tightening that we had in '88 and in '89, we think we're going to begin to see some dividends from that. I think there is some evidence of that in the squeeze in profit margins now; despite rising labor costs, firms are not able to pass that on to prices because there's more resistance to those prices. So, we are hoping that we'll do a little better on the inflation front than the staff is projecting.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Well, some of the things I wanted to say have been said. But I'll say a couple of things. I made that point about the forecast because a couple of things still trouble me about it even though I think the Greenbook forecast has been on track pretty well. In terms of the overall [picture] I don't think it's just the dollar that's the difference; if that were true, I think you'd expect to see most of the weakness in the exchange rate sensitive sectors. In fact, even though interest rates have been much lower than the scenario that we've been forecasting, interest sensitive sectors of the economy are the ones that are quite weak. Housing is down; automobiles are weak. Generally, the domestic interest sensitive sectors are part of the weak sectors in the economy. So I don't think it's just the fact that the dollar is strong; as a matter of fact if the dollar was that strong you'd expect more import demand than we're seeing as well, with the interest rates as low, and we're not seeing that either. So I think real interest rates at least are high enough to be causing a general slowing and that is feeding through to the inflation rate. I know it's not dramatic progress, but if you look at the core inflation rate changes, the CPI excluding food and energy was 4.7 percent in 1988 and it's running about 4 percent this year. The PPI ex-food and energy was about 4.8 percent last year and it's running about 4-1/2 percent so far this year. Intermediate prices ex-food and energy were 7.2 percent last year and are down to 1.7 percent so far. Crude materials are about the same. Those are all positives. I think the question is really how much risk we want to take. It's true that labor costs have not done as well as some of the improvement on the overall inflation rate. Labor costs seem to be running at about the same pace as last year. When I look at total compensation in nonfarm business or in the whole private sector area, that is running close to what it was last year both in the goods producing and the services components. But that's what's causing the profit squeeze and, as was pointed out, profits are falling significantly. And I think that's part of the process that has to work to hold the line on prices and actually get the benefit on inflation that we want. Again, I think the key question is really how much risk we want to take and what kind of timing we want for the improvement. We could get it all at once, but I'm not sure that's a risk we really want to take.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. The Fourth District is one of those Districts that has no natural disasters to report, although I know some of you believe that Cleveland is a continuing national--I mean natural--disaster.

MR. KELLEY. Did you say national disaster?

MR. HOSKINS. No, natural disaster. [That was a Freudian] slip. Not a lot has changed. We hear some of the same sentiments that you all have expressed around the table--namely, that there seems to be more caution expressed by business people but they can't find a lot of trouble right now in terms of their own businesses. They are still making commitments and making some investments. It's true that there is slowing in the growth rates of the order books, particularly on the capital goods side. Just one piece of anecdotal information that came out of the who has a major contract RV type of business, [unintelligible] retail, and he had attended a group meeting of these guys that do a lot of this sort of stuff and they said that the year, in terms of dollar volume, is going to be up significantly. So RVs seem to be continuing to move along, at least according to him. It is true that our unemployment rate is up about a full percentage point--from under 5 to about 6 percent in Ohio. Most of that, though not all of it, is just a slowing in the growth rate because we've had a very strong economy. But there is no [sense of] falling off the cliff that we could find as we searched around out there. People are pretty comfortable with inventories right now.

In terms of the national outlook, we have no disagreement with Mike's forecast. Now, I presume it's an unbiased forecast, which means to me that the errors could be equal on either side. Mike can say it better than I can--and that is that given the current forecast, the error one quarter out on real GNP could leave us either at the start of a recession or could leave us in what we would call a boom. So I guess I have some concerns that we're torturing our ability to forecast with this fine-tuning that we are doing currently. With respect to Ed's channel, I think we must have made a mistake because we've gone through the wrong channel. The channel that I thought we were after was one that was aimed at reducing the rate of inflation. The channel we're in here, according to the Greenbook forecast, is one of continuing inflation at about the current rate. So, I hope we can find our way to a new channel soon before we end up finding out that the inflation rate is actually accelerating.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. As far as the forecast, our bank staff forecast is still slightly stronger than Mike's forecast, as it has been for some time, but the differences are hardly statistically significant. And again, as it has been for some time, our inflation forecast is slightly higher. Leaving aside the technicalities of the forecast it does seem to me that the two major areas of uncertainty are capital goods and exports. And, of course, they're both related; they both get right to these questions that have been raised about the manufacturing sector. The point that Gary Stern made about keeping that in some perspective is very valid. I am a little more agnostic than some are in terms of trying to explain to my own satisfaction what is going on in the manufacturing sector and its possible implications for the economy at large. For example, I have a very, very hard time accepting the view that anything along the lines of the current level of either nominal or real interest rates should be capable of triggering a significant cumulative decline in the economy. Indeed, I'm not even sure myself--and I have not been for some time--how much of the slowing in the so-called interest sensitive sectors of the economy is really due to interest rates anyway, especially in a context in which the underlying prices of things like cars and houses and so on have been going up rather sharply, at least until recently.

I'm also a little perplexed by the exchange rate arguments. Certainly, as Mike or Ted said earlier, it's true that the exchange rate we are seeing is one that is a good deal stronger than was built into the forecast going back, say, nine months ago or something like that. But there too it seems to me that at least part of that stronger exchange rate is being offset by a stronger growth abroad than was being thought about early in this year. It seems to me that in the context of this uncertainty about net exports, and exports in particular, the current exchange rate in the face of the growth patterns that we're seeing in the rest of the industrialized world should be compatible with continued quite respectable growth in exports. Indeed, I'm beginning to worry that if that's not the case then something may be more seriously wrong than we think in terms of competitiveness or something. I can't quite bring myself to the view that even the current exchange rate, in the face of the very strong growth abroad, should not yield quite a respectable continued growth in net exports.

Now, the inflation situation I see as a Catch-22 in that I find it difficult to get too caught up in the inflationary prospects so long as the broad measures of wages and compensation are behaving the way they are. Indeed, if you look at our forecast and the Board staff's forecast, both now have unit labor costs growing faster than the deflator in a context in which, as Governor Johnson has pointed out, this profit squeeze is already very sharp. I don't see how you get any relief from that until you see the wage and compensation costs turn down. One of the worries I have is that if you build from where we are in terms of profits and profits as a share of GNP, what a period of four or five or six or seven quarters with a negative spread between unit labor costs and the deflator implies for profits raises some pretty serious questions in my mind about the implications for stock prices. The last point I would make, which is germane to these issues about manufacturing and the profits squeeze and exports, is that for the first three quarters of this year--if I remember the statistics right--the rate of net private investment for the economy as a whole is now down to 4.7 percent of GNP. And that is a very, very low number. And how we're going to get out from underneath a variety of these problems and get the productivity kicks that can really help us with this inflation problem with an investment rate of 4.7 percent of GNP is a real question.

CHAIRMAN GREENSPAN. That's called fiscal policy.

VICE CHAIRMAN CORRIGAN. I know that's what it's called.

CHAIRMAN GREENSPAN. Roger Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. There hasn't been a great deal of change in the Tenth District since the last meeting. There are two or three things that I'd like to comment upon, however. One of them is an analysis of our third-quarter farm credit survey that we do on a quarterly basis. That clearly is showing that a recovery in the agricultural sector is continuing, as evidenced by the fact that this was the 11th consecutive quarter where farmland values have increased; they are currently about 8 percent above year-ago levels and roughly 23 percent above year-end levels of 1986. One of the other things that's rather striking is that the loan-to-deposits ratio in agricultural banks, as opposed to all District banks, is only 51.4 percent, and that happens to be a high for the last three or four years. They are looking for loans and there is some takedown of credit within the farm area. However, agriculture has had a bumper year, notwithstanding the two years of drought, largely because product prices together with red meat prices--particularly cattle, and until recent times, pork--have been very high and sustained. Retail sales District-wide are roughly flat. However, in talking with the major retailers, they think their inventories are in line; they are looking for a normal or usual Christmas selling season and they feel very good about the positions they now occupy. With regard to manufacturing, it has steadily increased. There is the problem of Boeing--with Wichita being fairly heavily dominated by Boeing--and their being out on strike. On the other hand, the auto assembly plants that we have are still going full tilt, meaning two full shifts. The exception to that is a GM plant in Kansas City that is now on a two-week shutdown and I'm told that they anticipate an additional two weeks at or near year-end. They are cutting back their production to meet the forecast of auto sales on a national level. With regard to prices, we don't have any clear evidence that there is any strong pressure on prices. The real problem that is beginning to show through on the wages is the cost of fringe benefits and that will be amplified a bit in the first quarter with the additional social security requirement.

With regard to the national forecast, we have no quarrel with the projections that are contained in the Greenbook. For the fourth quarter we might be a couple of tenths weaker than the Greenbook would show. That simply tells me that if our primary objective is to slow the economy below its natural rate, then we're on track; I don't think we should panic. As a result, hopefully, we will get some indication of lower inflation rates. However, this forecast doesn't reveal that as far as I'm concerned. The Vice Chairman of the Board made some comments about evidence of lower prices; he reads the numbers differently than I do, I guess. Regional management differs--

MR. JOHNSON. I was just quoting the numbers ex-food and energy. If you look at the totals it's not quite as clear.

MR. GUFFEY. I understand. The last thing I would note is that unemployment in the Tenth District in all four of the major cities in which the Bank operates is below the national rate of unemployment. Some of that may be as a result of out-migration that took place in the more difficult times; but there is potential for some price/wage increases as a result of our labor shortage. That's all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Wayne Angell.

MR. ANGELL. I have the same question. My hunch is that the fourth and first quarters are going to be somewhat weak, as forecast. But if you look at the more forward-looking items such as money growth, we have had M2 back on a fairly decent pace for about five months now and I've been surprised that commodity prices haven't continued to move down. I know they have moved down in certain of the industrial measures, but it seems to me a pretty isolated group of commodity prices that are continuing to move down. And they haven't moved down very much in comparison to how much they moved up in the 1987-1988 period. So, it seems to me that we have a ways to go in regard to restraint on those commodity prices. We had a serious drought, which took farm commodity prices up a great deal. We have not had what you would call a normal movement of commodity prices down, which you would typically get; that is, going back over the post World War II drought periods, ordinarily you would get more movement down of commodity prices than we have had. I'm somewhat [stymied] in my view concerning where we are because commodity price behavior hasn't been what I thought it was going to be. I guess that's one of the problems you have when you begin to target something; perhaps you ought not to look at what you think it's going to say. I think there are times when you [unintelligible] not see as much; it does not give me the sense of an economic slowdown that I felt in 1985 and 1986. It just isn't there. And I think it's crucial that it get there because the wage sector is no longer lagging as much as we would like. It's kind of upon us and we probably have some tough periods ahead.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I think one of the times when you have to be careful is when you get what you want, which is pretty much what has happened here. It's a time to be careful because you have to develop a pretty careful view of what it is that you want to do next. We have the slowing that we looked for and that does leave us with the questions that Governor Johnson raised a little while ago: How slow is it going to get? How slow do we want it to get? And a more practical question is: What are the best ways to influence the process properly? To me, this quest for price stability that we're all on and believe in is playing itself out against the background of some pretty powerful and large forces. The inflationary forces we pretty well understand. We have an overemployed and overconsuming economy and all that that represents. But I'm haunted by what seem to be some underlying disinflationary forces that I wish I understood better than I do. They seem to me to be having a powerful influence, perhaps, on the favorable results we've been getting over the last year on inflation. Given the very full economy that we've got, inflation did not take on a life of its own to the extent that we might have expected it to a year ago. It seemed to stop what upward momentum it had before there was really much of an apparent slowdown in the economy. I wonder what underlies that? The major force that I can see is that there seems to be a tremendous amount of very low cost capacity in a wide variety of industries and commodities around the world. And capital is doing a very efficient job of seeking that out and exploiting it and holding costs down. I think the downsizing of GNP that you've spoken of very eloquently, Mr. Chairman, is a factor. It seems to me that we may be entering an era where we're servicing debt more than creating debt, which is deflationary. I don't know what all those forces are, if I can use that word, but they seem to be manifested in this profit squeeze that we have going on now--with costs being pushed up and the inability to pass that on through prices. That would be inflationary. But it can't go on forever; something has got to give. I certainly hope it's on the cost side. But maybe a key conceptual approach from a policy standpoint is that we really don't want either side to win too terribly conclusively. If inflation becomes dominant, we know what that scenario would be and that's unacceptable. In the slowdown scenario that we have here, it may be time to begin to think a bit about the power of those underlying deflationary forces--I guess I should say disinflationary at this point; they could become deflationary and lead us into some really serious problems that might be avoidable. I don't know that that's something that we have to deal with right now but I think it's something that we should keep in the back of our minds and strive to understand or get a better grasp on--at least better than I have. Thank you.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I just have a couple of comments. I think this quarter and the next two are probably going to be quite weak, possibly even turning in some red ink performance. I believe the weakness will be centered in manufacturing--because we already have seen that--and also in construction to some extent. Some of my contacts in manufacturing indicate that in their view manufacturing is already in a recession or within a gnat's eyebrow of being there. To use autos as a specific example, I have been talking to people in the last few days in that industry and they are the most negative I've seen--not since 1985 or 1986 but since 1982. That is probably because production is running about what it was in 1982. While they expected a payback from the sales spurt in August and early September, which of course was a result of the very generous incentives, they didn't expect this much of a payback. The very weak October and early November sales performance has come as an unpleasant surprise, at least to my contacts. There were a couple of things I heard mentioned for the first time from these folks. One was the complications coming from the weak financial condition of a number of the automobile dealers, including very large dealers. The statistic given to me was that about half of the auto dealers in this country are losing money in 1989. We're not just talking about a small marginal group but a very major group. And that tends to lead to an unwillingness to carry the same size inventories as previously because the dealers just don't have the wherewithal to fund it. Therefore, at the moment you're seeing a very poor flow of orders to the producers from the dealers. It's a combination of the weak consumer demand for cars and also the efforts of the dealers to cut back their existing inventory levels. There are still apparently quite a few carryover 1989 [models] that they would like to dispose of but haven't been able to.

Another interesting thing came up in the comments of He said a number of the dealers were telling him that some of their would-be buyers of Cadillacs are saying that they are knocked out of the market at the moment because their ARM mortages had adjusted upwards and, even though they're "in the bucks" so to speak, they are finding their monthly payment going up--these are people who don't live in shacks like I do--by $400, $425, or $450 and apparently that's just enough to discourage some of them from going ahead and buying a new automobile at the same time. That's the first time I heard that comment. Also, this unpleasant surprise is forcing a basic analysis of how much manufacturing capacity they really need. Chrysler is looking at this and so is GM. I think GM has four plants, although they haven't identified the exact four or five, that are going to be shuttered for good. Believe it or not, we've been concerned about capacity constraints; well, on autos we've had excess capacity and new capacity coming on stream all the time. So there are going to be these more permanent adjustments taking place--not in Roger's District; he's very lucky. But the assembly plant down the street from my old apartment in Detroit is getting it February 2nd. So, I would change places with you if your business is too strong down there. Also, I heard mentioned [by my contacts in the auto industry] concern over the strong dollar and what that is doing in the high-priced end of the market, particularly because expensive German cars are now coming into this country at sort of bargain prices. And this is making it more difficult for the American manufacturers to compete with them. Also, the rather feeble efforts of Chrysler to do some exporting of cars is now being impeded by the stronger dollar this year.

Finally, I'd like to mention just a couple of things I've been picking up about construction and housing. One is the sad impact of the FIRREA legislation on the ability of builders to get loans because S&Ls apparently haven't had the kinds of lending limits on individual loan size that banks have had. Now with FIRREA they do; it's 15 percent of their capital. So, a number of developers are having a hard time getting loans of the size they need to do these developments. Also, the HUD parade of homes march is on and the competition from the foreclosed homes, at least in some parts of the country, is very significant. And that is tending to keep discouraged builders from putting up new homes. So, my personal feeling is that we're going to see further problems in both the manufacturing arena and in construction. I hope I'm wrong. We'll find out by fourth of July next year.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Thank you, Mr. Chairman. I must say that I can't find any fault with the Greenbook projection except that it's not what I'd like to see.

MR. HOSKINS. Don't let that stop you!

MR. LAWARE. It's particularly discouraging to see a projection of further significant deterioration in the employment numbers coupled with no projected improvement in the inflation rate, at least as measured by the CPI. We have in the Greenbook here a two-year look toward the near nirvana of stable prices that we have subscribed to, with no progress toward that end. And that means that we're 40 percent of the way there without having gotten there yet. It makes one wonder, given the lackluster economy that's projected here, if the only way to see less inflation is recession. And I don't like that. At the same time, that's coupled with information about corporate profits that, even adjusted for the losses of the banks in the third quarter due to [loan loss] provisioning, are certainly not very robust. And when corporate profits are being constrained by narrower margins [unintelligible]--and these are not just confined to the automobile industry, they are widespread across American industry today--then you have to start hacking away at the costs. And the first place you start that is with employment. We're seeing it in computers; we're seeing it in autos; we're seeing it in banks; and we're beginning to see some evidence of it, I think, in the defense industry. If we haven't already, it certainly looks like it's coming down the trail. At the same time, we have a number of fragilities that remain out there: the banks; the overhang in the real estate markets with the RTC situation; and even some other areas which have looked until very recently to be a lot healthier. And then of course you have the punk-junk market, which I think is balanced on a very thin knife's edge. Recession to my way of thinking is a decidedly dangerous alternative because I think the bulwarks by which we try to insulate ourselves or our industries against external shock are very thin. And if the economy in fact is any softer underneath than the Greenbook would seem to indicate, then we may be closer to the edge of the abyss than was indicated. And with that, I'm sure you can hear my dove-like wings flapping on the bridges.

MR. KELLEY. Along with mine.

CHAIRMAN GREENSPAN. With that, I think it probably would be desirable to break for coffee.

[Coffee break]

MR. KOHN. Mr. Chairman, I'll be brief--well, not too brief. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Kohn?

MR. MELZER. Don, this is unrelated to the presentation that you just made, but I wanted to ask you what you thought the frictional level of borrowing was. If it were necessary to inject more reserves, would you view it as a problem if the funds rate actually dropped below the discount rate?

MR. KOHN. Well, even under alternative A [the funds rate] would still be a point above the discount rate. The difficulty, I guess, is that we're obviously looking at close to frictional borrowing levels. If the Committee were to decide to ease, for example, I do think that Mr. Sternlight could inject some more nonborrowed reserves, attain a funds rate that wasn't somehow out of control in relation to the discount rate, and borrowing would decline. Now, we said that under alternative A you would get a $100 million [decline in borrowing] for the 50 basis point [decline in the funds rate]. I wonder whether it wouldn't be less than that, given where we are on what's probably a very steep portion of the borrowing function right now--whether it would take a very small change in borrowing to accomplish that easing in policy. I think it's possibly quite feasible. I don't think we're in a situation where we're in danger of somehow letting the funds rate/discount rate relationship get out of whack or losing control over where it's running now.

MR. HOSKINS. I'd like you to talk a little about why we don't have an alternative C. It surprises me that the risks of recession clearly dominate the staff thinking relative to the risks of inflation. Another way to say that is that to me it looks like Federal Reserve policy is designed to prevent the inflation rate from falling.

MR. KOHN. I gave this some thought. There were two major factors weighing in my mind for not having an alternative C. One was that not having it in the Bluebook didn't mean the Committee couldn't vote on it at the meeting if it wanted to. But the other factor was that policy had just eased and thinking about reversing that action after it had just been taken seemed so strange. And, we are just talking about policy between now and [the next meeting]--December 17th or 18th or whenever it is. So, I made a judgment that alternative C was so unlikely to be chosen that I didn't put it in the Bluebook.

MR. HOSKINS. Let me just follow up with a question about when you might bring it back in. What are the odds that money growth will go to 9 percent rather than 7 percent? Or if it stays at 7-1/2 percent through the year-end are we going to look at "C"?

MR. KOHN. Well, we expect it to stay at something close to the 7 percent range through year-end; and at the current level of interest rates we'd expect to see it growing about like that in the first quarter of next year. I certainly have no problem putting in an alternative C for those who are bothered by that level of money growth. As I said, we thought about it this time and didn't do it; but most of the time we have it in.

CHAIRMAN GREENSPAN. Alternative C will show up if anybody on the Committee wants alternative C to come back. Any other questions for Don? Let me get started on our last round robin. I think what we've been listening to today is really what our fundamental dilemma is--namely, that there is no viable clear-cut path that gets us to where we would like to be without some assistance from the fiscal side. I've made this point to the President and his associates and tried to explain, in effect, that there is a downside limit to how far short-term interest rates can go without retriggering inflationary expectations and a significant recession on the other side of that. There may be some dispute as to whether or not that level is 8-1/2 percent on the funds rate, or 8 percent, or if it was really 9 percent or even higher. But what I think is reasonably certain from everything we've been looking at and discussing today is that the flexibility that we have to achieve the dual goals of declining inflation and still sustainable growth clearly is a window--which may in fact not be there. In other words, I am talking in terms of Ed Boehne's and Lee Hoskins' various channels. Neither one of them may be opened in a practical way for us to drive through without some assistance on the fiscal side. I don't know to what extent that is going to be driven [unintelligible] but there is some clear indication from the White House at this stage that they may be getting serious. The business of letting the sequester stand is not altogether a sham. There are some fundamental discussions going on in private in that area. It looks to me as though what is likely to emerge is a partial sequester--that is, a sequester which will be permanent for three months, followed by some reconciliation bill which hopefully will get the type of [fiscal policy] that the Greenbook presupposes. But short of that, I'm not sure that we have a viable window.

I also would like to point out that we have some very peculiar values out there. Jerry Corrigan strikes a very important chord when he raises the issue that unit labor costs at this stage are seemingly locked in at an unacceptably high range and improvement on the inflation side presupposes the necessity of declining profit margins. And declining profit margins, in the context of where I read the real expected rate of return on American securities and American stocks, suggest to me that we are now in a bear market. If the bear market is rather soft and cuddly, that's fine; but if it decides to move rather fast then I think we will get some of the wealth effects in the GNP accounts and the economy will tilt over. I must say, however, that the data on orders suggest to me that they are still weak but they are not deteriorating; we're not getting any evidence at this stage, of which I'm aware, that suggests that we are on a slippery slope. I think orders are soft and backlogs are still eroding. I do think it is surprising that steel orders have flattened even though backlogs are down. Aluminum orders still continue quite weak. The respective commodity prices, I might add, are following the order patterns rather surprisingly well, which is suggestive of the fact that commodity prices are now sort of a new ordering indicator rather than an inflation [indicator] per se.

I think it's a very sensitive period for us and I'm not sure how we will come out. But I think we have to grope our way along. While not losing sight of our long-term goals, which I think are crucial, we also have to be careful not to fumble into a severe recession. That will make the capability of our achieving the long-terms goals politically unavailable to us. So, it's not going to be an easy next six months. In some of the most recent orders data I think there is at least some suggestion that we may well make it; but it's going to be close. I come out after all of that not knowing very much more to recommend than alternative B, asymmetric for no other reason than that's where we are at the moment. Wayne.

MR. ANGELL. Well, it seems to me that we're at a juncture here where it's time for us to pause and see what happens. The fourth quarter and the first quarter are the consequences of the monetary policy that we implemented in the second quarter and the third quarter. We are already past [influencing] those. Whatever these quarters turn out to be, it would be most unfortunate for us to have a slowdown--or a slowdown near to zero if it's that slow, which I don't think it is--and then not to capture the price level opportunity that you get from being there. It would just be such a waste to step up to that point and then not to capture the benefits. So, I think it's imperative that we not be too caught up in tuning in on the employment and output numbers that we're going to be seeing. I think we have to remain forward-looking. Most important, it seems to me that the dollar exchange rate is out there. And it seems to me that we cannot go through a period of substantial dollar weakness in foreign exchange markets without absolutely upsetting all the financial markets. The only way that I can see us not going through such a period is for us to make some gains on the trade balance in this window [of opportunity]. I am more encouraged from talking with central bankers in Europe and Japan concerning their growth prospects. We have an opportunity now for them to grow faster than we're going to grow and I guess I'm going to be on the optimistic side, as the Vice Chairman was, in regard to exports. It seems to me that our policy ought to be designed to keep nominal GNP in the 4 to 5 percent range and hope that we get a fantastic real GNP out of those numbers. If we hold to that kind of a pattern, then I think there's ample opportunity to [get] the exports we need to do or [get] the crowding out of imports. I think we're now moving in the period where that has to take place. So, Mr. Chairman, I also favor "B;" but frankly, I'm more of the symmetric mind in the sense that I would like us to be in a position that we not make another move in the near future without having a real concerted discussion of the FOMC concerning that.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I would favor "B" symmetric as well. I could live with "B" asymmetric, as you suggested. I have thoughts that I think are quite similar to those Wayne expressed. First of all--and I mentioned this on the "Call"--we've got to be careful in the short run about not overreacting to the current data. We've been on the move for some months now with policy. And if we made a mistake with policy I don't think we're making it now; we probably made it last winter or early spring. But we certainly have taken the steps over the last five or six months, as I view it, to put policy back on an appropriate longer-term course. The second point I would make relates to this longer-term view of what we've achieved over not quite a three-year period. If you go back to early '87, we were looking at 12 quarters of trend growth of money that was almost 12 percent and we brought that down over this period of time to a little less than 5 percent. That's reflected in the P* model. It's very consistent with our longer-term goals and I would just hate to see us trade all that progress away by overreacting.

My final point is that, to some extent, I think we have to be careful about how we characterize what we are doing. Even though we all believe in it and understand the benefits of zero inflation, however defined, I'm not so sure how broadly supported that would be. I've heard comments--not today, but around this table--about businessmen thinking the environment we have been in is just fine and why not just continue that, with inflation running 4 to 5 percent. So I think it's important [to recognize] as we look at what's going on here that there are some forces operating that are much bigger than we are in this sense. Now, it's not totally unrelated to monetary policy, but we've got this external imbalance situation that we're living with and that's imposing certain things on the economy. If we don't run the type of policy we've been running, which is consistent with that, there will be a much more drastic adjustment imposed on the economy. I suppose people could come up with a longer list, but to cite another example: we also have an adjustment going on to the unsustainable credit growth that we have observed, really, throughout this recovery. There are a lot of situations where people have geared their plans toward an economy growing much more rapidly than potential. To the extent that we can lay out a broader set of issues --that it's not just the Fed single-mindedly pursuing this price stability objective and ignoring all else--I think it would be to our benefit. I'm not sure how to do that. But I think that's a risk of where we are right now.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I would go along with "B" with asymmetric language. I recognize that we've done quite a bit of easing in recent weeks and that M2 is growing pretty strongly. Clearly, at some point, as Tom expressed it so well on the "Call" the other day--and Governor Angell has made the same point--we're going to have to start paying more attention to the aggregates and less to these short-term indicators of real economic activity or else we're going to be headed for a lot of trouble. I don't think we've reached that point just yet, but that's clearly a judgment call. Having said that, I think it is very essential that we keep our eyes firmly on our longer-term goal of bringing down inflation. Accordingly, I think any further easing, even that little amount permitted by the proviso, should be approached very, very cautiously.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I agree with the Chairman's proposal for "B" with asymmetric language. I think that's really where we are. The risk is clearly on the down side and I don't mean just on the real economy. If I didn't personally think that we weren't going to make better progress than the Greenbook has indicated on inflation, I wouldn't want to tilt that way. As the Chairman said, we're at the stage where we have to be very cautious and not risk tipping the economy into a major recession because I don't believe the general public is going to understand our causing a major disruption to get a percentage point or two out of the inflation rate when we're already around the 4 percent range. So, I'm a gradualist in that sense and I wear that band pretty proudly. I think we ought to be very careful and try to make gains in a sensible way. I don't think we have much more easing to do; I agree with Governor Angell on that point. What we're seeing in the economy now is the result of policy months ago and I think we're getting closer to where we ultimately want to be. Clearly, when the funds rate got down close to 6 percent in late '86 or early '87 it was too low. I think a lot of us thought oil prices were going to stay down better than they did. So I don't think we want to return to those types of interest rates. But at 8-1/2 percent on the funds rate we've still got a ways to go; and the markets are certainly anticipating that we have a ways to go, but not a lot though. And I think that's the point. The longer we wait, if the economy deteriorates on us, the more we're going to have to move. And that's something we ought to try to avoid. [We ought to be] seeking out where we ultimately want to be, getting there early enough, and then letting the lags work their way through. I think we're close to that stage but we ought to be positioned to make another modest move because I don't think there is any upside risk to that. I think that's where we should be.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I agree with alternative B and the asymmetrical directive. It comes down to risks--and I think the risks are on the down side--and how much you're willing to take a chance on the economy going down to get some gains on inflation. I think we have to view inflation in this current sensitive context in a longer-term view. So, I support where you come out, Mr. Chairman.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I support alternative B as well. I have a preference for symmetric language as a result of my concerns about inflation and the inflation rate incorporated in the forecast. I must admit that I'm not quite sure I fully understand the initial part of your statement about how, if we don't get help from the fiscal side, it may make it impossible I think you said to reach our objectives with regard to inflation.

CHAIRMAN GREENSPAN. Well, I don't know if it's impossible but I think it will be very difficult to do so without breaking the back of the economy.

MR. PARRY. I would hope that one thing we can look at in this study that is being done for next month is how the burden on the economy is affected by different assumptions about fiscal policy; because it's not obvious to me how the total burden on the economy changes with combinations of fiscal versus monetary policy. But I know how the burden on us changes. Okay?

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I agree with your suggestion basically because it's no change. Given what we did last week, I don't think we have much choice right now. I think we're in a very difficult situation. As Ed Boehne said, it is a question of risks; and I agree with Tom Melzer's point that some reality testing has to be done out there and I'm not quite sure how we get that to occur. But given the lags involved and what we've already done, I just don't think it makes any sense to make any changes at this time.

CHAIRMAN GREENSPAN. So you're "B" asymmetric?

MR. SYRON. Yes.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I agree with your assessment. It seems to me that in a broad sense we are accomplishing what we set out to do and that it's coming out about as we would have expected. I do think the discussion around the table indicates that the economy is far different this time than was the case the last time. Having said that, I think we've done quite a bit over the last month or two and this is an appropriate time to simply stand back and see how things work out. I'd be in favor of alternative B. I don't feel strongly about the language, but would have a slight preference for asymmetric.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I would support your recommendation, Mr. Chairman, of alternative B with asymmetric language. There are only [a few] thoughts I would add to this. Given the uncertainties about the near-term economic outlook, this may be a time to pay at least a bit more attention to the aggregates, to M2. Analytically that makes sense; also, M2 has responded in recent months more or less as expected and I think we can get some help there. If I fully believed the staff's inflation forecast for 1990 and 1991, I would be very discouraged about what we're facing. But the one thing I do conclude with that forecast is that I would be very worried about declines in the dollar from here on out.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I would associate myself with those who say we need to keep our eye on the long-term goal of price stability. And I certainly wouldn't want to give back the gains that we've made over time. However, I think we need to keep in the forefront of our minds that price stability is only one of the goals of monetary policy; it may be the primary one but I think we can't be seen as recession tolerant. And like you and other speakers earlier in the day, I think the risk of recession is beginning to grow. I think what we've done is sufficient for the moment; I would stand back and wait at the moment. But I have a feeling that we may have to ease a little more before the end of the year. So, I would favor your proposal of alternative B with asymmetric language.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Yes, Mr. Chairman, I favor "B" asymmetric; I probably could tilt a little more toward asymmetric than we have in the past, but I'll leave it the way it is.

VICE CHAIRMAN CORRIGAN. Asymmetric prime.

MR. LAWARE. Yes.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I would agree with alternative B; I have a fairly strong preference for symmetric language. Also, I agree with those who have already expressed the view that the inflation forecast that we have in the Greenbook doesn't show very much progress there. Granted, we have risks on the down side of the economy; but on the other hand, I'm not sure that we've had the opportunity to see all of the effects flowing through of what we have done in terms of ease over the last few months. I guess I'm hoping that that will keep us from slipping into recession. But I think we would make a bad mistake if we really didn't keep inflation fairly high in importance.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I hate to be odd man, or woman, out again, but I feel fairly strongly that we are running the risk of a recession. And if we are worried, as I am, about the waning strength of the economy going into next spring, say, the steps have to be taken now to influence it at that time because of the well known lags involved. If I were convinced by my illustrious colleagues here that throwing us into the recession tank would solve our inflation problem I probably would vote differently. But I don't see that a recession is going to offset the impact of unwise legislation--by our friends under the dome down the street here--that would put upward pressure on business costs. I don't think that a recession is going to solve the medical care costs and the nursing shortage. Maybe we ought to deal with recruiting more nurses and getting rid of some of the excess lawyers who are chasing ambulances and getting big settlements which are driving up costs and not try to deal with it through a recession. These are the kinds of things that are contributing to inflation. I have a hard time seeing at the moment that it's excessively strong demand and shortages of capacity. So, having stated all that, I would prefer alternative A. Actually, when I look at the difference between "A" and "B" as described here by Don Kohn it isn't as if the one is going to produce monetary growth double the other. You're talking about really rather modest differences but sufficiently great, I think, to make a difference come next spring. I would go for "A."

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I support your suggestion of "B" asymmetric. I think that weakness is far more apparent than strength and I think we need to be very careful with it here. "B" is where we are now and I would certainly hate to appear, however implicitly and indirectly, to be taking a stronger stance than we presently have. I think it's extremely likely that any change that we would make in the intermeeting period would be to the accommodative side and that we should reflect that in the directive. I also do not think that that precludes the possibility that we can continue to make some small progress on inflation, as we have done in recent months and quarters.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I've been looking for some time for an opportunity to agree nearly 100 percent with Wayne Angell. And I do.

MS. SEGER. It must be bonus time!

SPEAKER(?). It wouldn't be so bad.

MR. BOEHNE. I realize it's getting late.

MR. GUFFEY. I think you stated it very well. We have had easing over the last four or five months of roughly 1-1/4 or 1-3/8 percent, which on a base of something less than 9 percent is a substantial easing. To be sure, the outlook is for [the expansion] to be slow in the fourth quarter and into the first quarter; in my view, that's what's needed. I'm not sure that that's enough to get us to the objective that I think we all would like to achieve--and that is something closer to price stability, however defined. As a result, given that we sort of preempted this meeting by an easing a week or so ago, clearly I'd favor maintaining what we have now with a B alternative. I would still opt for a symmetric directive because I don't know what an asymmetric directive now means, Mr. Chairman. We took two cuts in the intermeeting period which is a little beyond what I thought even an asymmetric directive meant without a vote.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" asymmetric is acceptable to me. But I do want to associate myself with those who are suggesting a need for great caution at this point.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. My only comment on where we are right now has to do with our experience when we attempt to prolong expansions and that is: that will induce a recession at some point if we pursue that path. I think what Roger Guffey has indicated, and Wayne did before, is right on target: that where we are now is a function of what we did earlier. If we were concerned about a continuing monetary policy mistake, then we ought to check the aggregates. If they were shrinking or not growing then I would say yes, we ought to be easing because we're making a monetary policy mistake. But in fact they are growing. In terms of the proposal in front of us, I would again agree with Roger Guffey that given where we are there's not much choice. I'd prefer "B." [Unintelligible] reminds us that there are two sides to risks in a situation; we ought to be reminded of that and take a look at that on a regular basis. So, I think we ought to go with "B."

I don't believe in fine-tuning. We've made the move, so let's live with it for a while.

CHAIRMAN GREENSPAN. I read the general inclination here as being modestly in favor of "B" asymmetric but--to capture Bob Black's words--should we move, that we should approach ease very cautiously. I think that's the spirit of what I hear around this table. Let's put that to a vote.

MR. BERNARD. Should I read the--

CHAIRMAN GREENSPAN. Yes, please.

MR. BERNARD. It would read: "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 7-1/2 and 4-1/2 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Guffey	Yes
Governor Johnson	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
President Melzer	Yes
Governor Seger	No
President Syron	Yes

CHAIRMAN GREENSPAN. The next meeting is--

MR. BERNARD. December 18-19.

CHAIRMAN GREENSPAN. December 18th and 19th.

VICE CHAIRMAN CORRIGAN. What's the timing going to be?

MR. PARRY. Are we going to meet Monday afternoon?

VICE CHAIRMAN CORRIGAN. I think for the sake of the items [on the agenda] we ought to start at 12:30 p.m.; we better start earlier than 3:00 p.m.

CHAIRMAN GREENSPAN. Hold it, everyone. Jerry Corrigan is raising a question of whether we ought to start earlier.

VICE CHAIRMAN CORRIGAN. Earlier than 3:00 p.m. on Monday.

MR. KEEHN. Don't we have a fairly long paper coming up?

VICE CHAIRMAN CORRIGAN. That's what I mean. It seems to me that we really should be prepared to devote a good solid chunk of time to these issues. I would suggest starting much earlier than usual; I don't know about people's travel.

SPEAKER(?). How about 1:00 p.m.?

CHAIRMAN GREENSPAN. 1:00 p.m. and have lunch here?

SPEAKER(?). Yes.

CHAIRMAN GREENSPAN. Is that satisfactory to everyone?

VICE CHAIRMAN CORRIGAN. No, have lunch at 12:00 noon and start work at 1:00 p.m.

SPEAKER(?). That's good.

MR. ANGELL. At least 12:30 p.m. for lunch.

SPEAKER(?). On the 18th or 19th?

CHAIRMAN GREENSPAN. Let's start lunch at 12:30 p.m. and start the meeting at 1:00 p.m. Is that satisfactory?

MR. PRELL. Mr. Chairman, the 18th is a Monday; there's a Board meeting. I don't know what the agenda is to be--

CHAIRMAN GREENSPAN. In my judgment, this preempts the Board meeting.

MR. ANGELL. We can start the Board meeting at 9:30 a.m.

SPEAKER(?). It'll be a long day!

END OF MEETING